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In addition to overall market forces, our business was also affected by other developments that had significant impacts late in the year. Spending by large North American customers shifted due to carrier consolidation and the timing of a wireless technology upgrade. In addition, the business combination between historical Alcatel and Lucent that we announced in April 2006 and completed in November 2006 created short–term uncertainty that impacted our results for the fourth quarter in several ways. From a customer perspective, the transaction created uncertainty about which products and services the combined company would maintain and which would be phased out or delayed. The announcement in September 2006 of our pending UMTS acquisition from Nortel further added to this customer uncertainty. We have since completed a portfolio rationalization plan and we are communicating that plan to our customers. From an employee perspective, the pending transaction created uncertainty among our employees as head count reductions would be part of the integration. We have instituted a new operating model and organizational structure and begun to work through our integration plan, which we expect will alleviate some of our employees' uncertainty.

Outlook for 2007. We expect to make total pre–tax cost savings of €1.7 billion by 2009, with at least €600 million of such savings in 2007. These savings take into account such factors as the optimization of the supply chain and services, optimization of resources and product rationalization. These actions should improve our competitiveness in our industry, but are expected to impact approximately 12,500 jobs over the next three years. We believe that the uncertainties of the fourth quarter of 2006 linked to the merger and a highly competitive market environment will diminish over time, but will continue to have an impact, on our operations in the early months of 2007. We expect some decline in revenues for the first quarter of 2007, but we believe that we can return to growth during the remainder of 2007. Looking forward to the full year 2007, we expect revenues to increase on a percentage basis in an amount at least equal to the carrier market growth rate of mid–single digits.

Recent Events. Our board of directors has announced that it will propose at the annual shareholders' meeting to be held on June 1, 2007 to pay a dividend of €0.16 per ordinary share and ADS for 2006.

At the extraordinary general shareholders' meeting held on January 5, 2007, Thales' shareholders approved the resolutions relative to the contribution of our transportation and security activities to Thales. On January 5, 2007, the two activities were transferred to Thales and we received 25 million new Thales shares and a cash payment of €50 million including purchase price adjustments. The sale of our space activities to Thales for cash should be finalized during the first half of 2007.

Highlights of Transactions during 2006. On January 27, 2006, we acquired a 27.5% stake in 2Wire, a pioneer in home broadband network solutions, for a purchase price of U.S.$122 million in cash. This company is accounted for under the equity method and its contribution to our 2006 net income was not significant. Goodwill accounted for in share of net assets of equity affiliates as of December 31, 2006 was €37 million.

On April 2, 2006, historical Alcatel and Lucent announced that they had entered into a definitive merger agreement. Completion of the merger took place on November 30, 2006 and Lucent became a wholly owned subsidiary. As a result, Alcatel, the parent company changed its name to Alcatel Lucent.

During the second quarter of 2006, we acquired privately–held VoiceGenie for €30 million in cash. Founded in 2000, VoiceGenie is a leader in voice self–service solutions, with a software platform based on Voice XML, an open standard used for developing self–service applications by both enterprises and carriers. The initial allocation of the cost of the business combination led to recognizing U.S.$12 million of depreciable intangible assets and U.S.$19 million of goodwill, with net assets of this company of U.S.$7 million at the acquisition date (of which U.S.$4 million of cash and cash equivalents). The contribution of this company to our 2006 results was not significant.

On April 5, 2006, we announced that the Board of Directors of Thales had approved in principle the acquisition of our satellite subsidiaries, railway signaling business and our integration and services activities for mission–critical systems not dedicated to operators or suppliers of telecommunications services. On December 1, 2006, we and Thales signed a definitive agreement relating to this transaction. The transaction primarily consists of the disposal and contribution by us to Thales of the following assets:

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1. In the space sector:

- our 67% stake in the capital of Alcatel Alenia Space (this joint venture company, created in 2005, is the result of combining our and Finmeccanica's Space assets, the latter holding a 33% stake);
- our 33% share in the capital of Telespazio, a worldwide leader in satellite services, of which 67% is held by Finmeccanica.

With respect to the disposal of the space activities, a cash payment of €670 million will be made to us which may be adjusted upward following an independent expert's review that should take place in the second half of 2008.

2. In the domain of critical systems for security:

- Transport Systems activities, a worldwide leader in signaling solutions for rail transport and urban metros;
- Critical Systems Integration activities not dedicated to operators or suppliers of telecommunications services and covering mainly the transport and energy sectors.

The assets to be included in the contribution and disposal have been accounted for as assets held for sale in our 2006 consolidated financial statements.

In August 2006, we acquired Fujitsu's share in Evolium 3G, our wireless infrastructure joint venture with Fujitsu.

On September 1, 2006, we announced that we had signed a non−binding Memorandum of Understanding with Nortel to acquire its UMTS radio access business (UTRAN) and related assets for U.S.$320 million in cash. On December 4, 2006, we signed a final agreement with Nortel and we completed the transaction on December 31, 2006.

On December 5, 2006 subsequent to the completion of the business combination with Lucent, Standard & Poor's downgraded our credit ratings to BB− (current as of March 28, 2007) from BB for our long−term debt, citing the challenges that we will face combining two large organizations. On December 11, 2006, Moody's downgraded our credit ratings to Ba2 (current as of March 28, 2007) from Ba1 for our long−term debt, citing execution challenges relating to the integration of two large companies.

Highlights of Transactions during 2005. On March 17, 2005, we completed the acquisition of Native Networks, Inc., a provider of optical Ethernet transport solutions, for U.S.$55 million in cash. On March 16, 2005 we sold our shareholding in Nexans, representing 15.1% of Nexans' share capital, through a private placement. On January 26, 2005, we completed the sale of our electrical power business to Ripplewood, a U.S. private equity firm.

On March 15, 2005, we amended our existing syndicated revolving €1.3 billion credit facility by extending the maturity date from June 2007 to June 2009 with a possible extension until 2011, eliminating one of the two financial covenants, reducing the cost of the facility and reducing the overall amount to €1.0 billion.

On April 11, 2005, Moody's upgraded to Bal from Ba3 the ratings for our long−term debt on the basis of cost savings achieved by us and our balance sheet strength.

On July 1, 2005, we completed the merger with of our space activities with those of Finmeccanica, S.p.A., an Italian aerospace and defense company, through the creation of two sister companies. We own approximately 67%, and Alenia Spazio, a unit of Finmeccanica, owns approximately 33%, of the first company, Alcatel Alenia Space, that combines our respective industrial space activities. Finmeccanica owns approximately 67%, and we own approximately 33%, of the second company, Telespazio Holding, which combines our respective satellite operations and service activities.

In July 2005, we exchanged our 45% shareholding in our joint venture with TCL Communication Technology Holdings Limited (see "Highlights of Transactions during 2004" below) for shares of TCL Communication, which resulted in TCL Communication owning all of the joint venture company and our owning 141,375,000 shares of TCL Communication.

Highlights of Transactions during 2004. On December 16, 2004, we completed the acquisition of Spatial Communications Technologies, Inc. for consideration consisting of our ADSs having a value of €223 million (based on the market value of our ADSs on the date of the acquisition). Spatial developed and marketed mobile switching equipment that can operate using any of the major mobile technologies and related software. On September 17, 2004, we acquired eDial for consideration consisting of cash and ADSs having an aggregate value of €22 million (based on the market value of our ADSs on the date of the acquisition). eDial provided conferencing and related services for businesses and carriers.

In January 2004 we completed the sale of Saft, our battery business, to Doughty Hanson, a European private equity firm, for €390 million in cash. On December 14, 2004, we sold a portion of our shareholding in Avanex in a block trade market transaction, which reduced our shareholding in this company to 19.65% of its share capital. From the date of this sale we do not treat Avanex as an equity affiliate, since we consider that we no longer exercise significant influence on the company.

In August 2004, we formed a joint venture with TCL Communication, which was owned 55% by TCL Communication and 45% by us. We contributed cash and our mobile handset business having an approximate aggregate value of €45 million, to the joint venture and TCL contributed €55 million in cash. In July, 2004, we combined our global fiber and communication cable business with that of Draka Holding, N.V., a Dutch cable and cable systems producer, and created a new company, Draka Comteq B.V., owned 50.1% by Draka and 49.9% by us. Draka Comteq B.V. holds the global optical fiber and communication cable business previously owned by the parties.

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Consolidated Results of Operations for the Year Ended December 31, 2006 Compared to the Year Ended December 31, 2005

Introduction. As noted earlier, on November 30, 2006, pursuant to a merger agreement that historical Alcatel and Lucent entered into on April 2, 2006, Lucent became a wholly owned subsidiary of Alcatel. On April 5, 2006, we announced that the Board of Directors of Thales had approved in principle the acquisition of our satellite subsidiaries, railway signalling business and integration and services activities for mission–critical systems not dedicated to operators or suppliers of telecommunications services. On December 1, 2006, we and Thales signed a definitive agreement relating to this transaction.

The following discussion takes into account our results of operations under IFRS for the year ended December 31, 2006, (i) including Lucent's results of operations starting on December 1, 2006 and (ii) excluding the businesses to be transferred to Thales. As a result of purchase accounting treatment of the Lucent business combination required by IFRS, our results for 2006 included several negative, non–cash adjustments. In addition, the following discussion takes into account our results of operations for the year ended December 31, 2005 which have been re–presented as required by IFRS, to exclude the businesses to be transferred to Thales, which are shown as discontinued operations.

Revenues. Consolidated revenues increased by 9.5% to €12,282 million for 2006, primarily driven by the services and enterprise business segments as well as the wireline group, compared to €11,219 million for 2005. Of the 9.5% increase, a significant portion is attributable to Lucent's results in December 2006. The difference between the 9.5% increase and the percentage change in our revenues based on a constant euro/U.S. dollar exchange rate is marginal since the average exchange rate was €1.26 = U.S.$1 in 2006 versus €1.24 = U.S.$1 in 2005.

Revenues (by geographical market of customer) in Europe decreased to €4,867 million in 2006 from €4,927 million in 2005; revenues in the United States increased to €2,323 million in 2006 from €1,572 million in 2005; revenues in Asia Pacific increased to €2,116 million in 2006 from €1,779 million in 2005; revenues in Other Americas (Canada, Central and South Americas) increased to €1,113 million in 2006 from €978 million in 2005 and revenues in the rest of the world decreased to €1,863 million in 2006 from €1,963 million in 2005. In 2006, Europe, U.S., Asia Pacific, Other Americas and the rest of the world accounted for 39.6%, 18.9%, 17.2%, 9.1% and 15.2%, respectively, of our total revenues compared with the following percentages of revenues for 2005: Europe 43.9%, U.S. 14.0%, Asia Pacific 15.9%, Other Americas 8.7% and the rest of the world 17.5%.

Gross Profit. Gross profit of €4,070 million in 2006 represented 33.1% of revenues compared to 36.8%, or €4,134 million, in 2005. The decrease in gross profit margin was primarily due to competitive pricing pressures in our carrier markets. Gross profit also included the non–recurring negative, non–cash impact of €167 million upon the sale of a portion of Lucent's inventory during December 2006. As a result of purchase accounting for the Lucent business combination, Lucent's inventory was revalued to its net realizable value and such "step–up" in valuation was reversed once the inventory was sold. Gross profit for 2006 was also adversely affected by (i) a net impairment charge on customer receivables of €18 million in 2006 as compared with a net gain of €19 million in 2005, as the amount of new reserves in 2006 exceeded the amount generated from the reversal of historical reserves and (ii) a net charge of €59 million for write–downs of inventory and work in progress compared with a charge of €18 million in 2005, due to fewer reversals of reserves during 2006 compared with 2005.

Administrative and Selling Expenses. Administrative and selling expenses were €1,910 million for 2006 compared to €1,815 million in 2005. As a percentage of revenues, administrative and selling expenses were 15.6% of revenues in 2006 compared to 16.2% of revenues in 2005, decreasing despite the increase in revenues primarily due to the decrease in certain costs resulting from our restructuring efforts. Administrative and selling expenses in 2006 included a negative, non–cash impact of purchase accounting entries resulting from the Lucent business combination of €30 million, primarily related to the amortization for one month of purchased intangible assets of Lucent, such as customer relationships.

Research and Development Costs. Research and development costs were €1,466 million in 2006 compared to €1,298 million in 2005. As a percentage of revenues, research and development costs amounted to 11.9% in 2006 as compared to 11.6% in 2005. Research and development costs in 2006 included a negative, non–cash impact of purchase accounting entries resulting from the Lucent business combination of €30 million, primarily related to the amortization for one month of purchased intangible assets of Lucent, such as acquired technologies and in process research and development.

Income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities. We recorded income from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities of €694 million for 2006 compared to €1,021 million for 2005. Income from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities as a percentage of revenues was 5.7% for 2006 compared to 9.1% in 2005. This decrease resulted from the competitive pricing environment that impacted our gross profit despite decreases in our fixed cost structure, and from the negative, non–cash impact of purchase accounting entries resulting from the Lucent business combination of €227 million, which more than offset Lucent's one–month contribution to revenues and gross margin.

Changes in provisions adversely impacted income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entries by €195 million. Additional product sales reserves created during 2006 were €376 million while provision reversals during 2006 were €226 million, of which €181 million related to product sales reserves. Of the €181 million, €94 million related to reversals of warranty provisions due to the revision of our original estimate for warranty provisions regarding warranty period and costs. This revision was due mainly to (i) the earlier than expected replacement of products under warranty by our customers with more recent technologies and (ii) the product's actual performance leading to fewer warranty claims than anticipated and for which we had made a reserve. In addition €33 million of the €181 million reversal of product sales reserves was mainly related to reductions in probable penalties due to contract delays or other contractual issues or in estimated amounts based upon statistical and historical evidence. The remaining reversals were mainly related to new estimations of losses at completion. Due to the re–presentation of our 2005 financial results as required by IFRS to present the businesses to be transferred to Thales as discontinued operations, we are unable to determine the amount of changes in provisions for 2005 for the businesses re–presented for such years.

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Restructuring Costs. We recorded €707 million for restructuring costs in 2006 compared to €79 million in 2005. Restructuring costs in 2006 are primarily based on an impairment loss recorded as a result of streamlining and phasing out technologies of historical Alcatel in light of the UMTS radio access business acquired from Nortel in December 2006 and the Lucent business combination. The corresponding write-off and the estimated associated future costs for which we have already committed at December 31, 2006 represented €494 million, which has been accounted for in our 2006 restructuring costs. In addition, pursuant to the business combination with Lucent, some of Lucent's product lines and businesses have been discontinued and the corresponding restructuring costs, of €120 million at December 31, 2006 have been recorded in the income statement.

Impairment of Intangible Assets. In 2006, we had €141 million of impairment charges against intangible assets, primarily linked to our carrier segment. There was no impairment charge in 2005.

Gain (Loss) on Disposal of Consolidated Entities. In 2005, we recorded a gain on the disposal of consolidated entities of €129 million related to the merger of our satellite activities with those of Finmeccanica. An additional gain of €15 million was recorded in 2006 due to a positive adjustment to that sales price.

Income (Loss) from Operating Activities. Income (loss) from operating activities was a loss of €139 million in 2006 compared to income of €1,071 million in 2005. This decrease was due primarily to major restructuring costs in 2006, impairment charges on intangible assets booked in 2006 (as compared to no charge in 2005) and the reduced gain from the disposal of consolidated entities in 2006.

Finance Costs. Finance costs were €98 million in 2006 compared to €93 million in 2005 and included financial interest paid on gross financial debt of €241 million which was partly offset by financial interest received on cash and cash equivalents of €143 million. This evolution is consistent with the average net (debt) cash position of the Group during 2005 and 2006.

Other Financial Income (Loss). Other financial loss was €112 million in 2006 compared to income of €43 million in 2005. This decrease was due primarily to capital gains resulting from the disposal of shares that we owned in Nexans (€69 million) and Mobilrom (€45 million) in 2005 as compared with non-recurring financial charges in 2006, including a €18 million charge related to the adjustment of the conversion ratio of Lucent's Series A and Series B convertible debentures following a consent solicitation completed in the fourth quarter of 2006 and a €15 million charge representing an interest charge due to late payment of a debt relating to a tax dispute.

Share in Net Income (Losses) of Equity Affiliates. Share in net income (loss) of equity affiliates was income of €22 million compared to a loss of €14 million in 2005. The change was primarily due to a loss in 2005 in connection with our share in TAMP (the joint venture for mobile handsets we had created with TCL Communication Technology Holding Limited in August 2004) for €32 million. TAMP was no longer an equity affiliate in 2006 due to the swap of our 45% interest in the joint venture we owned for 4.8% in TCL Communication Holding Limited during 2005. The 2006 share in net income of equity affiliates is mainly related to our stake in Thales.

Income (loss) Before Tax, Related Reduction of Goodwill and Discontinued Operations. Income (loss) before tax, related reduction of goodwill and discontinued operations was a loss of €327 million in 2006 compared to income of €1,007 million in 2005.

Income Tax (Expense) Benefit. Income tax (expense) benefit was a net benefit of €42 million in 2006 compared to a net expense of €146 million in 2005. The net income tax benefit for 2006 resulted from a current income tax expense of €71 million (compared with a current income tax expense of €48 million in 2005) more than offset by a deferred income tax benefit of €113 million mainly due to the amortization for one month of Lucent's intangible assets resulting from the purchase price accounting entries made in connection with the Lucent business combination that are not deductible for tax purposes (compared with a deferred income tax charge of €98 million in 2005).

Income (Loss) from Continuing Operations. Loss from continuing operations was €290 million compared to income of €861 million in 2005.

Income (Loss) from Discontinued Operations. Income from discontinued operations was €159 million in 2006 corresponding mainly to the businesses that will be transferred to Thales in 2007 (as discussed above and in Note 3 of our consolidated financial statements) compared to income generated primarily by those businesses of €110 million in 2005.

Minority Interests. Minority interests were €45 million in 2006 compared to €41 million in 2005, due primarily to lower results from Alcatel Shanghai Bell.

Net Income (Loss) Attributable to the Equity Holders of the Parent. As a result of the foregoing, we recorded a net loss (Group share) of €176 million in 2006 compared to a net income of €930 million in 2005.

Results of Operations by Business Segment for the Year Ended December 31, 2006 Compared to the Year Ended December 31, 2005

Introduction. The following discussion takes into account our results of operations under IFRS for the year ended December 31, 2006, (i) including Lucent's results of operation starting on December 1, 2006, (ii) excluding the businesses to be transferred to Thales, and (iii) treating the business segments established after the business combination with Lucent as if they were effective on January 1, 2006. In addition, the following discussion takes into account our results of operations for the year ended December 31, 2005 which have been re-presented, treating the business segments established after the business combination with Lucent as if they were effective on January 1, 2005 and, as required by IFRS, excluding the businesses to be transferred to Thales, which are presented as discontinued activities.

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The table below sets forth the consolidated revenues (before elimination of inter-segment revenues, except for "Other" and "Total Group" results), income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities and capital expenditures for tangible and intangible assets for each of our business segments for 2006 and 2005.

In millions of €	Carrier	Enterprise	Service	Other	Total Group
Year ended December 31, 2006					
Revenues:					
Of which :					
– Wireline	*4,463*	–	–	–	
– Wireless	*3,049*	–	–	–	
– Convergence	*1,477*	–	–	–	
TOTAL	**8,989**	**1,420**	**1,721**	**152**	**12,282**
Income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities	393	109	195	(3)	694
Capital expenditures for tangible and intangible assets	473	84	29	98	684

In millions of €	Carrier	Enterprise	Service	Other	Total Group
Year ended December 31, 2005					
Revenues:					
Of which :					
– Wireline	*3,876*	–	–	–	
– Wireless	*2,806*	–	–	–	
– Convergence	*1,781*	–	–	–	
TOTAL	**8,463**	**1,248**	**1,378**	**130**	**11,219**
Income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities	778	111	212	(80)	1,021
Capital expenditures for tangible and intangible assets	407	80	45	61	593

Carrier Segment

Revenues of the carrier segment were €8,989 million in 2006, an increase of 6.2% over revenues of €8,463 million in 2005. Most of the increase was is attributable to Lucent's activity in December 2006. Within the carrier segment, demand for the wireline group's products was particularly strong, driven by the continued migration to all-IP networks in carriers' core as well as their access networks, and continued spending to enhance broadband access capabilities. There was also an acceleration in carrier spending to deploy video and voice-over IP (or VoIP) services as part of their new offer of triple-play services, enabled by their upgraded access networks. The increased volume of high-bandwidth traffic – like video – also added to carrier spending for additional capacity in both their metro area and long-haul optical networks. Revenues of our wireline business group were €4,463 million for 2006, compared to €3,876 million for 2005, an increase of 15.1%. Lucent's activity in December 2006 did not contribute materially to such increase.

Our wireless business group was impacted by a number of developments. Carriers continued to introduce and enhance their high-speed data capabilities, continuing to add capacity to their networks as subscribers and traffic volumes increased. However, we experienced certain adverse developments in 2006, including (i) the diminishing number of 2G greenfield deployment projects in emerging countries, (ii) our selective commercial policy to deliberately abstain from large contracts where risks are high in the medium term and (iii) customers' hesitation to make investments in 3G projects with us pending completion of the Nortel UMTS radio access transaction. Revenues of our wireless business group were €3,049 million for 2006, compared to €2,806 million for 2005, an increase of 8.7% that was primarily attribuable to Lucent's activity in December 2006

Our convergence business group revenues were primarily impacted by the decline in our fixed and mobile line voice circuit-based switching businesses as our customers transition to next generation networks and therefore reduce their capital expenditures for legacy, narrow band switching. At the same time, there has been increasing interest in next-generation network architecture – like IMS – and the new service capabilities of that architecture. However, the evolution of carrier networks to that architecture is a long-term cycle, and spending for next-generation IMS products and capabilities is not yet sufficient to offset the decline in spending for core legacy equipment. Revenues of our convergence business group were €1,477 million for 2006, compared to €1,781 million for 2005, a decrease of 17.1%, which was partially offset by the inclusion of Lucent's results in December 2006.

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Income from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities was €393 million for 2006 compared with €778 million in 2005, a decrease of 49.5%. The decrease resulted from a competitive pricing environment; from our significant investments in next generation technologies such as NGN, IMS, and WiMAX, aimed at securing leading positions in future network builds; and from the negative impact of purchase accounting entries resulting from the Lucent business combination.

Enterprise Segment

Enterprise segment revenues were €1,420 million in 2006, an increase of 13.8% over revenues of €1,248 million in 2005. The inclusion of Lucent's activity in December 2006 had no significant impact on this increase. The segment posted steady gains throughout the year, driven by the ongoing migration to IP telephony, strong demand in IP networking and the segment's strong position in contact center solutions.

Income from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities was €109 million for 2006 compared to €111 million in 2005, a decrease of 1.8%. This decrease was primarily due to the competitive pricing pressure in our business communication activity, while the profitability of our contact center business remained fairly stable.

Services Segment

Services segment revenues were €1,721 million in 2006, an increase of 24.9% over revenues of €1,378 million in 2005; more than half of this increase was attributable to Lucent's results in December 2006. The transformation to an all-IP infrastructure is driving an increasing need for network integration services to address the complex end-to-end solutions our customers are deploying. Our services business is also seeing increased opportunities associated with the evolution to converged or blended services, network optimization and the outsourcing of network operations. Income from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities was €195 million for 2006 compared with €212 million in 2005, a decrease of 8.0%. The decrease reflected a competitive pricing environment and our investment in a new IP network integration and test facility, which is a part of our strategy to support operators worldwide in their IP transformation projects.

Consolidated Results of Operations for the Year Ended December 31, 2005 Compared to the Year Ended December 31, 2004

Introduction. The following discussion takes into account our results of operations for the years ended December 31, 2005 and 2004, each of which has been re-presented as required by IFRS to exclude the businesses to be transferred to Thales, which are shown as discontinued operations.

Revenues. Consolidated revenues increased by 9.3% to €11,219 million for 2005, primarily driven by the mobile communications segment, compared to €10,263 million for 2004. Approximately 40% of our consolidated revenues are denominated in or linked to the U.S. dollar. When we translate these revenues into euros for accounting purposes, there is an exchange rate impact based on the relative value of the U.S. dollar and the euro. During 2005, the decreases in the value of the U.S. dollar relative to the euro had a negative impact on our revenues. If there had been a constant euro/U.S. dollar exchange rate in 2005 as compared to 2004, our consolidated revenues would have increased by approximately 9.8%. This is based on applying (i) to our sales made directly in U.S. dollars or currencies linked to U.S. dollars effected during 2005, the average exchange rate that applied in 2004, instead of the average exchange rate that applied in 2005, and (ii) to our exports (mainly from Europe) effected during 2005 which are denominated in U.S. dollars and for which we enter into hedging transactions, our average euro/U.S. dollar hedging rate that applied in 2004. Our management believes that providing our investors with our consolidated net revenues in constant euro/U.S. dollar exchange rates facilitates the comparison of the evolution of our revenues with that of the industry. The table below sets forth our revenues as reported, the conversion and hedging impact of the euro/U.S. dollar and our revenues at a constant rate:

	2005	2004	% of change
Revenues as reported	€11,219	€10,263	9.3%
Conversion impact euro/U.S. dollar	2	—	—%
Hedging impact euro/U.S. dollar	59	—	0.5%
Revenues at constant rate	€11,280	€10,263	9.8%

Revenues (by geographical market of customer) in Europe increased to €4,927 million in 2005 from €4,575 million in 2004; revenues in America (including North America and Central and South America) increased to €2,550 million in 2005 from €2,355 million in 2004; revenues in Asia-Pacific increased to €1,779 million in 2005 from €1,728 million in 2004; and revenues in the rest of the world increased to €1,963 million in 2005 from €1,605 million in 2004. In 2005, Europe, America, Asia-Pacific and the rest of the world accounted for 43.9%, 22.7%, 15.9% and 17.5%, respectively, of our total revenues compared with the following percentages of revenues for 2004: Europe 44.6%, America 22.9%, Asia-Pacific 16.8% and the rest of the world 15.6%.

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Gross Profit. Gross profit of €4,134 million in 2005 represented 36.8% of revenues compared to 39.5%, or €4,094 million, in 2004. The decrease in gross profit margin was primarily due to competitive pricing pressures in our carrier markets.

Administrative and Selling Expenses. Administrative and selling expenses were €1,815 million for 2005 compared to €1,771 million in 2004. As a percentage of revenues, administrative and selling expenses were 16.2% of revenues in 2005 compared to 17.3% of revenues in 2004, decreasing on a percentage basis primarily due to the decrease in our fixed costs structure resulting from our restructuring efforts as well as a result of our revenue operational leverage.

Research and Development Costs. Research and development costs were €1,298 million in 2005 compared to €1,320 million in 2004. As a percentage of revenues, research and development costs amounted to 11.6% in 2005 as compared to 12.9% in 2004.

Income (Loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities. We recorded income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities of €1,021 million for 2005 compared to €1,003 million for 2004. Income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities as a percentage of revenues was 9.1% for 2005 compared to 9.8% in 2004. This decrease resulted from the competitive pricing environment that impacted our gross profit despite decreases in our fixed costs.

Due to the re-presentation of our 2005 and 2004 financial results as required by IFRS to present the businesses to be transferred to Thales as discontinued operations, we are unable to determine the amount of changes in provisions for 2005 and 2004 that impacted the income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities re-presented for such years.

Restructuring Costs. We recorded €79 million for restructuring costs in 2005 compared to €313 million in 2004. The restructuring costs for 2005 reflected new restructuring plans attributable to continuing head count reductions in Germany, Spain and France. The decrease was as a result of the substantial completion of our earlier major restructurings.

Impairment of Intangible Assets. In 2005 we did not record any impairment of intangible assets. An impairment of capitalized development costs of €88 million was recorded in 2004, primarily linked to our fixed communication segment.

Gain (Loss) on Disposal of Consolidated Entities. We recorded a gain on the disposal of consolidated entities of €129 million related to the merger of our satellite activities with those of Finmeccanica.

Income (Loss) from Operating Activities. Income from operating activities amounted to €1,071 million in 2005 compared to €602 million in 2004. This increase was due primarily to lower restructuring costs in 2005 compared to 2004, the gain in connection with the merger of our satellite activities and the absence of an impairment of capitalized development costs in 2005.

Finance Costs. Finance costs were €93 million in 2005 compared to €108 million in 2004 and included financial interest paid on gross financial debt of €215 million which was partly offset by financial interest received on cash and cash equivalents of €122 million. The decrease in financial costs was due to a decrease in our financial debt in 2005 compared to 2004 and an increase in our net cash position.

Other Financial Income (Loss). Other financial income was €43 million in 2005 compared to €32 million in 2004. This increase was due primarily to capital gains resulting from the disposal of shares that we owned in Nexans (€69 million) and Mobilrom (€45 million), offset in part by impairment losses of financial assets.

Share in Net Income (Losses) of Equity Affiliates. Share in net losses of equity affiliates was a loss of €14 million compared to a loss of €61 million in 2004. The main cause of the decrease reflected the fact that Avanex was no longer an equity affiliate in 2005 due to the sale of a portion of our shareholdings in Avanex in December 2004.

Income Before Tax, Related Reduction of Goodwill and Discontinued Operations. Income before tax, related reduction of goodwill and discontinued operations was €1,007 million in 2005 compared to €465 million in 2004.

Income Tax Expense. Income tax expense was €146 million in 2005 compared to €34 million in 2004. The charge for 2005 resulted from a current income tax expense of €48 million (compared with a current income tax benefit of €83 million in 2004 mainly due to the favourable outcome of tax litigations) and from a deferred income tax charge of €98 million (compared with a deferred income tax charge of €117 million in 2004).

Income (Loss) from Continuing Operations. Income from continuing operations was €861 million compared to €431 million in 2004.

Income (Loss) from Discontinued Operations. Income from discontinued operations was €110 million in 2005, principally related to the businesses to be transferred to Thales. For 2004 income from discontinued operations of €214 million reflected the businesses to be transferred to Thales as well as net income from various activities discontinued in the course of the year, primarily the battery activities disposed to Saft, optical fiber activities, mobile phones and electrical power systems activities.

Minority Interests. Minority interests were €41 million in 2005 compared to €69 million in 2004, due primarily to lower results from Alcatel Shanghai Bell.

Net Income (Loss) Attributable to the Equity Holders of the Parent. As a result of the foregoing, we recorded net income (group share) of €930 million in 2005 compared to €576 million in 2004.

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Results of Operations by Business Segment for the Year Ended December 31, 2005 Compared to the Year Ended December 31, 2004

The following discussion takes into account our results of operations for the years ended December 31, 2005 and 2004, (i) each of which has been re–presented, as required by IFRS, to exclude the businesses to be transferred to Thales, which are shown as discontinued operations and (ii) treating the business segments established after the business combination with Lucent as if they were effective on January 1, 2004.

The table below sets forth the consolidated revenues (before elimination of inter–segment revenues, except for "Other" and "Total Group" results), income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities, and capital expenditures for tangible and intangible assets for each of our business segments for 2005 and 2004.

In millions of euros

2005	Carrier	Enterprise	Services	Other	Total Group
Total – Revenues	**8,463**	**1,248**	**1,378**	**130**	**11,219**
Of which:					
– *Wireline*	*3,876*	–	–	–	–
– *Wireless*	*2,806*	–	–	–	–
– *Convergence*	*1,781*	–	–	–	–
Income (loss) from operating activities before restructuring costs, Impairment of intangible assets and gain/(loss) on disposal of consolidated entities	**778**	**111**	**212**	**(80)**	**1,021**
Capital expenditures (tangible and intangible assets)	407	80	45	61	593

In millions of euros

2004	Carrier	Enterprise	Services	Other	Total Group
Total – Revenues	**7,573**	**1,211**	**1,266**	**213**	**10,263**
Of which:					
– *Wireline*	*3,538*	–	–	–	–
– *Wireless*	*2,297*	–	–	–	–
– *Convergence*	*1,738*	–	–	–	–
Income (loss) from operating activities before restructuring costs, Impairment of intangible assets and gain/(loss) on disposal of consolidated entities	**699**	**120**	**181**	**3**	**1,003**
Capital expenditures (tangible and intangible assets)	348	75	39	66	528

Carrier Segment

Revenues of our carrier segment were €8,463 million for 2005, compared to €7,573 million for 2004, an increase of 11.8%. Every business group within the segment contributed positively to the revenue growth.

Our wireless business group was the principal contributor to the revenue growth, with revenues of €2,806 million for 2005, compared to €2,297 million for 2004, an increase of 22.2%. This increase was due to significant increases in all businesses, particularly as a result of the continuing growth of our GSM 2/2.5G radio access products in emerging countries.

Our wireline business group revenues also increased to €3,876 million for 2005, compared to €3,538 million for 2004, an increase of 9.6%. Increases in revenues were reported in our optical business, driven by new submarine projects, as well as sustained demand in the terrestrial metro sector coming from the preparation by our carrier customers for deployment of triple play (voice, data and video) services, and growth in our IP business that supplies products to transmit data through high bandwidth in the networks. Even though we continued to increase our line deliveries in our broadband access business (21.6 million in 2005, as compared to 19.6 million in 2004), our broadband access revenues declined slightly due to substantial pricing pressures.

Our convergence business group revenues also increased to €1,781 million for 2005, from €1,738 million for 2004, an increase of 2.5% primarily due to our mobile voice switching business and to our multimedia and payment application businesses. This revenue increase was partially offset by continued decline in our fixed line voice circuit–based switching business as our customers transition to next generation networks and therefore reduce their capital expenditures for narrow band switching.

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Our carrier segment's income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities was €778 million for 2005 (9.2% as a percentage of revenues), compared to €699 million in 2004 (9.2% as a percentage of revenues).

Enterprise Segment

Revenues of our enterprise segment were €1,248 million for 2005, compared to €1,211 million in 2004, an increase of 3.1%. This increase was primarily due to our IP telephony and applications.

The enterprise segment's income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities was €111 million for 2005 (8.9% as a percentage of revenues), compared to €120 million in 2004 (9.9% as a percentage of revenues).

Services Segment

Revenues of our services segment were €1,378 million for 2005, compared to €1,266 million in 2004, an increase of 8.8%, broadly reported across every service subsegment.

Our services segment's income (loss) from operating activities before restructuring costs, impairment of intangible assets and gain/(loss) on disposal of consolidated entities was €212 million for 2005 (15.4% as a percentage of revenues), compared to €181 million in 2004 (14.3% as a percentage of revenues). This increase was primarily due to the operational leverage and the containment efforts of our fixed cost structure.

Liquidity and Capital Resources

Liquidity

Cash Flow for the Years Ended December 31, 2006 and 2005.

Cash Flow Overview

Cash and cash equivalents increased by €360 million in 2006 to €4,749 million at December 31, 2006. This increase was mainly due to the cash provided by operating activities of €351 million and net cash provided by investing activities of €761 million (mainly due to cash and cash equivalents held by Lucent at acquisition date), which was partially offset by cash used by financing activities of €699 million, due primarily to the cash repayment of long term debt, including repurchased debt, and the 2005 dividend paid in 2006.

Net Cash Provided (Used) by Operating Activities. Net cash provided by operating activities before changes in working capital, interest and taxes was €929 million compared to €882 million for 2005. This increase was primarily due to the effect of non-cash items that contributed to our net loss (group share) of €176 million in 2006, as compared with net income of €930 million in 2005, which included relatively few non-cash items. In order to calculate net cash provided by operating activities before changes in working capital, interest and taxes, the €176 million net loss for 2006 must be adjusted for financial, tax and non-cash items (primarily restructuring reserves, depreciation, amortization, impairments and provisions), net gain on disposal of non-current assets, changes in fair values and share based payments, and adjusted further for cash outflows that had been previously reserved (mainly for ongoing restructuring programs). Impairment of intangible assets, provisions, impairment losses and fair value changes represented a non-cash net charge of €657 million in 2006 (mainly related to impairment recorded in connection with discontinued product lines due to the acquisition of Nortel's UMTS business and the business combination with Lucent), as compared with a net cash outflow of €475 million in 2005 (of which €396 million pertained to restructuring payments). The net gain on disposal of non-current assets, amounting to €134 million in 2006, was mainly due to net capital gains on fixed assets as compared with a capital gain of €310 million in 2005 mainly due to a gain of €129 million related to the merger of 33% of Alcatel Space's satellite industrial activity with that of Finmeccanica and to a gain of €114 million upon the disposal of our holdings in Nexans and Mobilrom.

Net cash provided by operating activities was €351 million in 2006 compared to €610 million in 2005. These amounts take into account the net cash used by the increase in operating working capital, vendor financing and other current assets and liabilities, which amounted to €409 million in 2006 and €234 million in 2005. The main change between the two periods relates to the increase in cash used by other assets and liabilities and the increase in cash used due to lower working capital in 2006 than in 2005 as result of the stabilization of revenues. Interest, net and tax paid increased from €38 million in 2005 to €169 million in 2006 due to a one-time positive impact in 2005 related mainly to tax litigations.

Net Cash Provided (Used) by Investing Activities. Net cash provided by investing activities was €761 million in 2006. Excluding the impact of the cash and cash equivalents held by Lucent at acquisition date, equal to €1,391 million, net cash used by investing activities would have been €630 million in 2006 compared to €177 million in 2005. This increase in net cash used was mainly due to the acquisition of Nortel's UMTS business for €240 million in 2006 compared to the cash proceeds of €285 million received from the disposal of consolidated and non consolidated entities in 2005 (due mainly to the merger of 33% of Alcatel Space's satellite industrial activity with that of Finmeccanica). Cash proceeds from the sale of consolidated and non-consolidated entities in 2006 was €76 million. To a lesser extent, the change in net cash resulted from the increase in capital expenditures to €684 million in 2006 compared with €593 million in 2005.

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Net Cash Provided (Used) by Financing Activities. Net cash used by financing activities amounted to €699 million in 2006 compared to net cash used of €653 million in 2005. The primary changes were the decrease in the amount of cash received in 2006 from the issuance of short-term debt (€11 million in 2006 compared with €160 million in 2005) and the dividend payment of €219 million we made on our ordinary shares and ADSs in 2006, partially offset by the more limited use of cash to decrease our long-term debt (€516 million in 2006 compared with €805 million in 2005).

Disposed of or discontinued operations. Disposed of or discontinued operations represented net cash used of €11 million in 2006 compared with €5 million used in 2005.

Capital Resources

Resources and Cash Flow Outlook. We derive our capital resources from a variety of sources, including the generation of positive cash flow from on-going operations, the issuance of debt and equity in various forms, and banking facilities including the revolving credit facility of €1.4 billion maturing in April 2012 and on which we have not drawn (see "Syndicated Facility" below). Our ability to draw upon these resources is dependent upon a variety of factors, including our customers' ability to make payments on outstanding accounts receivable, the perception of our credit quality by debtors and investors, our ability to meet the financial covenant for our revolving facility and debt and equity market conditions generally.

Our short-term cash requirements are primarily related to funding our operations, including our restructuring program, capital expenditures and short-term debt repayments. We believe that our cash, cash equivalents and marketable securities, including short-term investments aggregating €6,691 million as of December 31, 2006, are sufficient to fund our cash requirements for the next 12 months. Approximately €622 million of such amount is held in countries, primarily China, and is subject to exchange control restrictions. These restrictions can limit the use of such funds by our subsidiaries outside of the local jurisdiction. We do not expect that such restrictions will have an impact on our ability to meet our cash obligations.

During 2007 we expect to make cash outlays for our restructuring programs of approximately €900 million, to make capital expenditures of approximately €1,050 million, including development expenditures that are capitalized and to pay dividends aggregating approximately €370 million. We repaid approximately €154 million in aggregate principal amount of our 5.625 % bonds that matured on March 12, 2007. On March 30, 2007, Lucent redeemed all of its outstanding 8% Convertible Subordinated Debentures due 2031. During 2007, depending upon market and other conditions, we may also continue our bond repurchase program in order to redeem certain of our outstanding bonds.

We can provide no assurance that our actual cash requirements will not exceed the currently expected cash outlays. If we cannot generate sufficient cash from operations to meet cash requirements in excess of our current expectations, we might be required to obtain supplemental funds through additional operating improvements or through external sources, such as capital market proceeds (if conditions are considered favorable by us), assets sales or financing from third parties, the availability of which is dependent upon a variety of factors, as noted above.

Credit Ratings. As of March 28, 2007, our credit ratings were as follows:

Rating Agency	Long-term debt	Short-term debt	Outlook	Last update of the rating	Last update of the outlook
Moody's	Ba2	Not Prime	Stable	December 11, 2006	December 11, 2006
Standard & Poor's	BB-	B	Positive	December 5, 2006	December 5, 2006

As of March 28, 2007, Lucent's credit ratings were as follows:

Rating Agency	Long-term debt	Short-term debt	Outlook	Last update of the rating	Last update of the outlook
Moody's	Ba3 (senior unsecured)	n.a.	n.a.	December 11, 2006	n.a.
Standard & Poor's	BB- (corporate credit rating) B+ (senior unsecured) (on Watch)	B-1	Positive	December 5, 2006	December 5, 2006

See below for ratings information on Lucent's subordinated debt and trust securities.

Moody's: Following the consummation of the business combination with Lucent, on December 11, 2006, Moody's set our Corporate Family Rating as well as our senior debt at Ba2 (our rating was at Ba1 prior to the announcement in March 2006 that historical Alcatel and Lucent were in merger discussions) with a Stable outlook. The "not prime rating" for our short term debt was confirmed. At the same time, Lucent's Corporate Family Rating was withdrawn. Lucent's obligations continue to be rated with its senior unsecured debt at Ba3 and subordinated debt and trust securities at B2.

The rating grid of Moody's ranges from Aaa, which is considered to carry the smallest degree of investment risk, to C, which is the lowest rated class. Our Ba2 rating is in the Ba category, which also includes Ba1 and Ba3 ratings. Moody's gives the following definition of its Ba category, "debt which is rated Ba is judged to have speculative elements and is subject to substantial credit risk."

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Standard & Poor's: Following the consummation of the business combination with Lucent, on December 5, 2006 Standard & Poor's set our long-term corporate credit rating at BB- (our rating was at BB prior to the announcement in March 2006 that historical Alcatel and Lucent were in merger discussions) with a positive outlook. Our B short-term corporate credit rating was affirmed. At the same time, Lucent's long-term corporate credit rating was equalized with ours at BB- with a positive outlook. Only Lucent's senior unsecured debt ratings (which is rated B+) remained on Credit Watch with positive implication. Lucent's subordinated debt is rated B and its trust securities are rated B-.

The rating grid of Standard & Poor's ranges from AAA (the strongest rating) to D (the weakest rating). Our BB- rating is in the BB category, which also includes BB+ and BB ratings. Standard & Poor's gives the following definition to the BB category: "[a]n obligation rated "BB" is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions, which could lead to the obligors' inadequate capacity to meet its financial commitment on the obligation."

We can provide no assurances that our credit ratings will not be lowered in the future by Standard & Poor's, Moody's or similar rating agencies. In addition, a security rating is not a recommendation to buy, sell or hold securities, and each rating should be evaluated separately of any other rating. Our current short-term and long-term credit ratings as well as any possible future lowering of our ratings may result in higher financing costs and in reduced access to the capital markets.

Our short-term debt rating allows us limited access to commercial paper, and the non-French commercial paper market is generally not available to us on terms and conditions that we find acceptable.

At December 31, 2006, our total financial debt, gross amounted to €6,209 million (of which €3,050 million pertained to Lucent's bonds) compared to €3,798 million at December 31, 2005.

Short-term Debt. At December 31, 2006, we had €1,161 million of short-term financial debt outstanding, which included €154 million of 5.625% Notes due March 2007 issued by historical Alcatel and €298 million of 8% Convertible Subordinated Debentures issued by Lucent (comprised of €369 million in principal amount less €71 million which was accounted for as an equity component), both of which have been repaid, and €138 million in commercial paper, with the remainder representing other bank loans and lines of credit and other financial debt and accrued interest payable.

Long-term Debt. At December 31, 2006 we had €5,048 million of long-term financial debt outstanding.

Rating Clauses Affecting our Debt. Alcatel-Lucent's and Lucent's outstanding bonds do not contain clauses that could trigger an accelerated repayment in the event of a lowering of its credit ratings.

Syndicated Facility. On November 10, 2006, the majority of the lenders participating in our €1 billion syndicated bank credit facility consented to the waivers needed to consummate the business combination with Lucent as well as the proposed disposals to Thales. Under the waiver, a clean-up period expiring on May 31, 2007 was granted, by which time we had to amend or refinance the facility to retain its availability to us. We have complied with the financial covenant that is included the €1 billion facility linked to our capacity to generate sufficient cash to repay our debt every quarter since June 2004, when the facility was established.

On April 5, 2007, we signed a €1.4 billion multicurrency syndicated revolving facility to replace the undrawn €1 billion syndicated facility historical Alcatel entered into in 2004. This new revolving credit facility has a five-year maturity, with two possible one-year extension options. The facility will be used for general corporate purposes and to refinance both the 2004 revolving facility described above and Lucent's U.S. $500 million revolving facility that terminated in March 2007, described below. The new facility is based on substantially the same terms and conditions as the 2004 facility, including the single financial covenant linked to our capacity to generate cash to reimburse our net debt. This ratio will continue to be tested every quarter. The availability of this facility is not dependent upon our credit ratings. We can provide no assurance that we will be compliant with this financial covenant in the future.

Lucent letter of credit agreements. Lucent had two primary letter of credit agreements, a letter of credit issuance and reimbursement agreement and an external sharing debt agreement. The aggregate outstanding obligations under these agreements was €119 million as of December 31, 2006. The agreements terminated effective March 28, 2007. Outstanding letters of credit previously governed by these agreements remain outstanding under bilateral arrangements with the issuing banks.

Contractual obligations and off-balance sheet contingent commitments

Contractual obligations. We have certain contractual obligations that extend beyond 2007. Among these obligations we have long-term debt and interest thereon, finance leases, operating leases, commitments to purchase fixed assets and other unconditional purchase obligations. Our total contractual cash obligations at December 31, 2006 for these items are presented below based upon the minimum payments we will have to make in the future under such contracts and firm commitments. Amounts related to financial debt, capital lease obligations and the equity component of our convertible bonds are fully reflected in our consolidated balance sheet included in this document.

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Contractual Payment Obligations	Payment Deadline				
	Before December 31, 2007	2008-2009	2010-2011	2012 and after	Total
In millions					
Financial debt (excluding finance leases)	€1,109	€1,053	€935	€3,060	€6,157
Finance lease obligations	52	—	—	—	52
Equity component of convertible bonds	218		105	543	866
Subtotal – included in our balance sheet	**€1,379**	**€1,053**	**€1,040**	**€3,603**	**€7,075**
Finance costs on financial debt (1)	333	554	438	1,857	3,182
Operating leases	261	401	307	518	1,487
Commitments to purchase fixed assets	40	35	—	—	75
Other unconditional purchase obligations (2)	503	131	4	—	638
Commitments of discontinued activities (3)	9	12	8	12	41
Subtotal – not included in our balance sheet	**€1,146**	**€1,133**	**€757**	**€2,397**	**€5,423**
TOTAL CONTRACTUAL OBLIGATIONS (4)	**€2,525**	**€2,186**	**€1,797**	**€6,000**	**€12,498**

(1) To compute finance costs on financial debt, all put dates have been considered as redemption dates. For debentures with calls but no puts, call dates have not been considered as redemption dates. Further details on put and call dates are given in Note 24 of our consolidated financial statements included elsewhere herein. If all outstanding debentures at December 31, 2006 were not redeemed at their respective put dates, we would incur an additional finance cost of approximately €1,010 million until redemption at their respective contractual maturities.
(2) Other unconditional purchase obligations result mainly from obligations under multi-year supply contracts linked to the sale of businesses to third parties.
(3) Commitments of discontinued activities correspond to operating leases of €39 million and other unconditional purchase obligations of €2 million held by entities to be disposed of or contributed to Thales (see Note 3 of our consolidated financial statements included elsewhere herein).
(4) Obligations related to pensions, post-retirement health and welfare benefits and postemployment benefit obligations are excluded from the table. Refer to Note 25 to our consolidated financial statements for a summary of our expected contributions to these plans.

Off-balance sheet commitments and contingencies. On December 31, 2006, our off-balance sheet commitments and contingencies amounted to €3,677 million, consisting primarily of €2,234 million in guarantees on long-term contracts for the supply of telecommunications equipment and services by our consolidated and non-consolidated subsidiaries (of which €780 million related to discontinued activities). Generally we provide these guarantees to back performance bonds issued to customers through financial institutions. These performance bonds and counter-guarantees are standard industry practice and are routinely provided in long-term supply contracts. If certain events occur subsequent to our including these commitments within our off-balance sheet contingencies, such as the delay in promised delivery or claims related to an alleged failure by us to perform on our long-term contracts, or the failure by one of our customers to meet its payment obligations, we reserve the estimated risk on our consolidated balance sheet under the line items "Provisions" or "Amounts due to/from our customers on construction contracts," or in inventory reserves. Not included in the €3,677 million is (i) approximately €414 million in customer financing provided by historical Alcatel, (ii) U.S.$27 million of loans representing customer financing by Lucent, (iii) our contingent liability pursuant to the securitization of other accounts receivable and (iv) the sale of a carry back receivable, each as described below.

With respect to guarantees given for contract performance, only those issued by us to back guarantees granted by financial institutions are presented in the table below.

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Off–balance sheet contingent commitments given in the normal course of business are as follows:

In millions	December 31, 2006	December 31, 2005
Guarantees given on contracts made by Group entities and by non–consolidated subsidiaries (1)	€1,454	€2,034
Discounted notes receivables (2)	€8	€—
Other contingent commitments (3)	€782	€624
Commitments of discontinued activities (4)	€794	€—
Subtotal – Contingent commitments (5)	**€3,038**	**€2,658**
Secured borrowings (6)	€60	€97
Guarantee in cash pooling (7)	€579	€639
TOTAL OFF–BALANCE SHEET COMMITMENTS, GUARANTEE IN CASH POOLING AND SECURED BORROWINGS (5)	**€3,677**	**€3,394**

(1) This amount is not reduced by any amounts that may be recovered under recourse or similar provisions, guarantees received, or insurance proceeds, as explained more fully below. Of this amount, €191 million as of December 31, 2006 and €216 million as of December 31, 2005 represent undertakings we provided on contracts of non–consolidated companies.

(2) This contingent liability relates to our obligation pursuant to the applicable law of certain jurisdictions (mainly France) to repurchase discounted notes receivable in certain circumstances, such as if there is a payment default.

(3) Included in the €782 million are: €100 million of guarantees provided to tax authorities in connection with tax assessments contested by us, €3 million of commitments of our banking subsidiary, Electro Banque, to third parties providing financing to non–consolidated subsidiaries, €90 million of commitments related to leasing or sale and leaseback transactions, €163 million primarily related to secondary lease obligations resulting from leases that were assigned to businesses Lucent spun–off or disposed of and €426 million of various guarantees given by certain subsidiaries in the Group. Included in the €624 million are: €101 million of guarantees provided to tax authorities in connection with tax assessments contested by us, €3 million of commitments of our banking subsidiary, Electro Banque, to third parties providing financing to non–consolidated subsidiaries, €90 million of commitments related to leasing or sale and leaseback transactions, and €430 million of various guarantees given by certain subsidiaries in the Group.

(4) Commitments of discontinued activities correspond to guarantees on third party contracts of €780 million and other contingent commitments of €14 million held by entities to be disposed of or contributed to Thales (see Note 3 of our consolidated financial statements included elsewhere herein).

(5) Excluding our commitment to provide further customer financing, as described below.

(6) The amounts in this item represent borrowings and advance payments received which are secured through security interests or similar liens granted by us. The borrowings are reflected in the Contractual Payment Obligations table above in the line item "Financial debt (excluding capital leases)."

(7) This guarantee covers any intraday debit position that could result from the daily transfers between our central treasury account and our subsidiaries' accounts.

The amounts of guarantees given on contracts reflected in the preceding table represent the maximum potential amounts of future payments (undiscounted) we could be required to make under current guarantees granted by us. These amounts do not reflect any amounts that may be recovered under recourse, collateralization provisions in the guarantees or guarantees given by customers for our benefit. In addition, most of the parent company guarantees and performance bonds given to our customers are insured; therefore, the estimated exposure related to the guarantees set forth in the preceding table may be reduced by insurance proceeds that we may receive in case of a claim.

Commitments related to product warranties and pension and post–retirement benefits are not included in the preceding table. These commitments are fully reflected in our 2006 consolidated financial statements included elsewhere herein. Contingent liabilities arising out of litigation, arbitration or regulatory actions are not included in the preceding table either, with the exception of those linked to the guarantees given on our long–term contracts.

Commitments related to contracts that have been cancelled or interrupted due to the default or bankruptcy of the customer are included in the above mentioned "Guarantees given on contracts made by Group entities and by non–consolidated subsidiaries" as long as the legal release of the guarantee is not obtained.

Guarantees given on third–party long–term contracts could require us to make payments to the guaranteed party based on a non–consolidated company's failure to perform under an agreement. The fair value of these contingent liabilities, corresponding to the premium to be received by the guarantor for issuing the guarantee, was €2 million as of December 31, 2006 (€2 million as of December 31, 2005).

In connection with our consent solicitation to amend the indenture pursuant to which Lucent's 2 ¾ Series A Convertible Senior Debentures due 2023 and 2 ¾ Series B Convertible Senior Debentures due 2025 were issued, on December 29, 2006 we issued a full and unconditional guaranty of these debentures. The guaranty is unsecured is subordinated to the prior payment in full of our senior debt and is pari passu with our other general unsecured obligations, other than those that expressly provide that they are senior to the guaranty obligations.

Customer Financing. Based on standard industry practice, from time to time we extend financing to our customers by granting extended payment terms, making direct loans, and providing guarantees to third–party financing sources. More generally, as part of our business we routinely enter into long–term contracts involving significant amounts to be paid by our customers over time.

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Historical Alcatel and Lucent have used, for purposes of their respective accounting, definitions of customer financing that do not have the exact same scope (the notion of customer financing is not defined in either IFRS or U.S. GAAP). Therefore, for purposes of our explanations of customer financing commitments in this annual report, we provided below a separate discussion of customer financing commitments for each of historical Alcatel and Lucent. We are currently working on harmonizing the criteria used, and should be able to discuss the customer financing provided by our Group in a unified manner in our 2007 annual report.

As of December 31, 2006, net of reserves, historical Alcatel had provided customer financing of approximately €414 million (which amount is not included in the table under "Off-balance sheet commitments and contingencies" above). This amount includes €400 million of customer deferred payments and accounts receivable, and no other financial assets. In addition, as of that date historical Alcatel had outstanding commitments to make further direct loans or provide guarantees to financial institutions in an amount of approximately €105 million.

The following table summarizes Lucent's customer financing commitments for amounts drawn and available but not drawn and committed but not available. Commitments for amounts available but not drawn and amounts committed but not available may expire without being drawn upon. The amounts drawn on these commitments are generally collateralized by substantially all of the assets of the respective creditors.

December 31, 2006

In millions USD	**Total loans and guarantees**	**Loans**	**Guarantees**
Drawn commitments (1)	$21.7	$21.3	$0.4
Available but not drawn (2)	11.3	6.0	5.3
Committed but not available (3)	34.5	34.5	–
TOTAL	**67.5**	**61.8**	**5.7**

(1) Of this amount, U.S.$0.4 million of guarantees is included in the table reflecting off-balance sheet contingent commitments discussed in "Contractual Obligations and Off-Balance Sheet Contingent Commitments" above.
(2) Of this amount, U.S.$5.3 million of guarantees is included in the table reflecting off-balance sheet contingent commitments discussed in "Contractual Obligations and Off-Balance Sheet Contingent Commitments" above.
(3) This represents financing commitments pursuant to executed agreements, where credit is not available for drawdown until certain conditions are met. This amount is included in the table reflecting off-balance sheet contingent commitments discussed in "Contractual Obligations and Off-Balance Sheet Contingent Commitments" above.

Drawn and undrawn commitments are monitored by assessing, among other things, each customer's short-term and long-term liquidity positions, the customer's current operating performance versus plan, the execution challenges facing the customer, changes in the competitive landscape and the customer's management experience and depth. When potential problems are evident, certain mitigating actions are taken, including cancellation of commitments. Although these actions can limit the extent of our losses, we remain exposed to the extent of drawn and guaranteed amounts.

Sale of carryback receivable. In May 2002, we sold to a credit institution a carryback receivable with a face value of €200 million resulting from the choice to carry back tax losses from prior years. The cash received from this sale amounted to €149 million, corresponding to the discounted value of this receivable, which matures in five years. Under IFRS, the carryback receivable is not removed from the balance sheet but is reported on the asset side of the balance sheet as an "other non current asset," at its discounted value using the discount rate applied in the sale transaction by the credit institution who purchased the receivable and as a "other long term debt" at its discounted value using the French state bonds' discount rate, on the liability side of the balance sheet.

We are required to indemnify the purchaser in case of any error or inaccuracy concerning the amount or nature of the carry-back receivable sold. The sale would be retroactively cancelled if future changes in law resulted in a substantial change in the rights attached to the carryback receivable sold.

Securitization of Accounts Receivable. In December 2003, we entered into a further securitization program for the sale of customer receivables without recourse. Eligible receivables are sold to a special purpose vehicle, which benefits from a bank financing, and from a subordinated financing from us representing an over-collateralization determined on the basis of the risk profile of the portfolio of receivables sold. This special purpose vehicle is fully consolidated under IFRS. This program was temporarily frozen in December 2006, and the balance of receivables sold at December 2006 was therefore zero. Receivables sold in previous years (€61 million at December 31, 2005 and €82 million at December 31, 2004) were maintained in our consolidated balance sheet. The December 2006 freeze had no impact on our balance sheet. At December 31, 2006, the maximum amount of bank financing that we could obtain through the sale of receivables was €150 million. The actual amount of such funding for each receivable is a percentage of the amount of the receivable and the percentage varies depending on the quality of the receivables sold. The purpose of this securitization program is to optimize the management and recovery of receivables, in addition to providing additional financing.

Lucent's Separation Agreements. Lucent is party to various agreements that were entered into in connection with the separation of Lucent and former affiliates, including AT&T, Avaya, Agere Systems and NCR Corporation. Pursuant to these agreements, Lucent and the former affiliates have agreed to allocate certain liabilities related to each other's business, and have agreed to share liabilities based on certain allocations and thresholds. We are not aware of any material liabilities to Lucent's former affiliates as a result of the separation agreements that are not otherwise reflected in our consolidated financial statements included elsewhere herein. Nevertheless, it is possible that potential liabilities for which the former affiliates bear primary responsibility may lead to contributions by Lucent.

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Lucent's Other Commitments – Contract Manufacturers. Lucent has outsourced most of its manufacturing operations to electronic manufacturing service (EMS) providers. Two EMS providers, Celestica and Selectron, supply most of Lucent designed wireless and wireline products. Celestica has the exclusive right to manufacture and provide most of Lucent's existing wireless products. Solectron Corporation consolidates the outsourced manufacturing of Lucent's portfolio of wireline products. The agreements with Celestica and Solectron are for a minimum of three years, with no right to terminate for convenience. Lucent is generally not committed to unconditional purchase obligations in these contract–manufacturing relationships. However, there is exposure to short–term purchase commitments when they occur within the contract manufacturers' lead–time for specific products or raw materials. These commitments were $309 million as of December 31, 2006. Sudden and significant changes in forecasted demand requirements within the lead–time of those products or raw materials could adversely affect our results of operations and cash flows.

Lucent's Guarantees and Indemnification Agreements. Lucent divested certain businesses and assets through sales to third–party purchasers and spin–offs to its common shareowners. In connection with these transactions, certain direct or indirect indemnifications were provided to the buyers or other third parties doing business with the divested entities. These indemnifications include secondary liability for certain leases of real property and equipment assigned to the divested entity and certain specific indemnifications for certain legal and environmental contingencies, as well as vendor supply commitments. The durations of such indemnifications vary but are standard for transactions of this nature.

Lucent remains secondarily liable for approximately $162 million of lease obligations as of December 31, 2006, that were assigned to Avaya, Agere and purchasers of other businesses that were divested. The remaining terms of these assigned leases and the corresponding guarantees range from one month to 14 years. The primary obligor under assigned leases may terminate or restructure the lease obligation before its original maturity and thereby relieve Lucent of its secondary liability. Lucent generally has the right to receive indemnity or reimbursement from the assignees and we have not reserved for losses on this form of guarantee.

Lucent is party to a tax–sharing agreement to indemnify AT&T and is liable for tax adjustments that are attributable to its lines of business, as well as a portion of certain other shared tax adjustments during the years prior to its separation from AT&T. Lucent has similar agreements with Avaya and Agere. Certain tax adjustments have been proposed or assessed subject to these tax–sharing agreements. The outcome of these other matters is not expected to have a material adverse effect on our consolidated results of operations, consolidated financial position or near–term liquidity.

Lucent's Guarantees of Certain of our Debt. On March 27, 2007, Lucent issued full and unconditional guaranties of our 4.375% bonds due 2009 (the principal amount of which was €805 million on December 31, 2006), our 6.375% notes due 2014 (the principal amount of which was €462 million on December 31, 2006) and our 4.750% Convertible and/or Exchangeable Bonds due 2011 (the principal amount of which was €1,022 million on December 31, 2006). Each guaranty is unsecured and is subordinated to the prior payment in full of Lucent's senior debt and is pari passu with Lucent's other general unsecured obligations, other than those that expressly provide that they are senior to the guaranty obligations.

Customer Credit Approval Process and Risks. We engage in a thorough credit approval process prior to providing financing to our customers or guarantees to financial institutions, which provide financing to our customers. Any significant undertakings have to be approved by a central Trade and Project Finance group and by a central Risk Assessment Committee, each independent from our commercial departments. We continually monitor and manage the credit we have extended to our customers, and attempt to limit credit risks by, in some cases, obtaining security interests or by securitizing or transferring to banks or export credit agencies a portion of the risk associated with this financing.

Although, as discussed above, we engage in a rigorous credit approval process and have taken actions to limit our exposure to customer credit risks, the global downturn and deterioration of the telecommunications industry through 2003 caused certain of our customers to experience financial difficulties and others to file for protection under the bankruptcy laws. Upon the financial failure of a customer, we realized losses on credit we extended and loans we made to our customers, on guarantees provided for our customers, losses relating to our commercial risk exposure under long–term contracts, as well as the loss of our customer's ongoing business. If economic conditions and the telecommunications industry in particular deteriorate once again, we may in the future realize similar losses. In such a context, should additional customers fail to meet their obligations to us, we may experience reduced cash flows and losses in excess of reserves, which could materially adversely impact our results of operations and financial position.

Capital Expenditures. We expect that our capital expenditures in 2007 will be approximately €1,050 million, including research and development expenditures that will be capitalized. We believe that our current cash and cash equivalents, cash flows and funding arrangements provide us with adequate flexibility to meet our short–term and long–term financial obligations and to pursue our capital expenditure program as planned. We base this assessment on current and expected future economic and market conditions. Should economic and market conditions deteriorate, we may be required to engage in additional restructuring efforts and seek additional sources of capital, which may be difficult if there is no continued improvement in the market environment and given our limited ability to access the fixed income market at this point. In addition, as mentioned in *"Capital Resources"* above, if we do not meet the financial covenant contained in our syndicated facility or if we are not successful in amending or refinancing this facility by May 31, 2007, we may not be able to rely on this funding arrangement to meet our cash needs.

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Qualitative and Quantitative Disclosures About Market Risk

Financial instruments

We enter into derivative financial instruments primarily to manage our exposure to fluctuations in interest rates and foreign currency exchange rates. Our policy is not to take speculative positions. Our strategies to reduce exchange and interest rate risk have served to mitigate, but not eliminate, the positive or negative impact of exchange and interest rate fluctuations.

Derivative financial instruments held by us at December 31, 2006 were mostly hedges of existing or future financial or commercial transactions or were related to issued debt.

The most important part of our issued debt is in euro. Interest rate derivatives are used to convert the fixed rate debt into floating rate in order to cover the interest rate risk.

Since we conduct commercial and industrial operations throughout the world, we are exposed to foreign currency risk, principally with respect to the U.S. dollar, but to a lesser extent with respect to the British pound and the Canadian dollar. We use derivative financial instruments to protect ourselves against fluctuations of foreign currencies which have an impact on our assets, liabilities, revenues and expenses.

Future transactions mainly relate to firm commercial contracts and commercial bids. Firm commercial contracts and other firm commitments are hedged using forward exchange contracts, while commercial bids are hedged using mainly currency options. The duration of future transactions that are not firmly committed does not usually exceed 18 months.

Counterparty risk

For our derivative financial instruments, we are exposed to credit risk if a counterparty defaults on its financial commitments to us. This risk is monitored on a daily basis, within strict limits based on the ratings of counterparties. The exposure of each market counterparty is calculated taking into account the nature and the duration of the transactions and the volatilities and fair value of the underlying market instruments. Counterparties are generally major international banks.

Foreign currency risk

Derivative foreign exchange instruments are mainly used to hedge future sales denominated in non–euro currencies.

Since we are a net seller of non–euro currencies, the rise of the euro against these currencies would have a positive impact on the fair value of the hedges. However, most of the change in fair value of derivative financial instruments would be offset by a change in the fair value of the underlying exposure.

Interest rate risk

In the event of an interest rate decrease, the fair value of our fixed–rate debt would increase and it would be more costly for us to repurchase it (not taking into account that an increased spread of credit reduces the value of the debt).

In the table below, the potential change in fair value for interest rate sensitive instruments is based on a hypothetical and immediate one percent fall or rise for 2006 and 2005, in interest rates across all maturities and for all currencies. Interest rate sensitive instruments are fixed–rate, long–term debt or swaps.

	December 31, 2006				December 31, 2005			
In millions of euros	Booked value	Fair value	Fair value variation if rates fall by 1%	Fair value variation if rates rise by 1%	Booked value	Fair value	Fair value variation if rates fall by 1%	Fair value variation if rates rise by 1%
Assets								
Marketable securities	1,942	1,942	10	(11)	641	641	0	0
Cash and cash equivalents (1)	4,749	4,749	0	0	4,509	4,509	0	0
Liabilities (2)								
Convertible, non convertible bonds and other financial debt	(6,209)	(6,518)	(571)	495	(3,798)	(4,141)	(138)	130
Interest rate derivative	26	26	49	(46)	107	108	82	(77)
(Debt)/Cash position	508	199	(512)	438	1,459	1,117	(56)	53

(1) For bank overdrafts, the booked value is considered as a good estimation of the fair value.
(2) Over 99% of our bonds have been issued with fixed rates. At year–end 2006 and 2005, the fair value of our long–term debt was higher than its booked value due to falling interest rates.

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Assumptions and Calculations

The fair value of the instruments in the table above is calculated with market standard financial software according to the market parameters prevailing on December 31, 2006.

Fair value hedge

The ineffective portion of changes in fair value hedge was a loss of €18 million at December 31, 2006 compared with a loss of €9 million at December 31, 2005 and a loss of €2 million at December 31, 2004. We did not have any amount excluded from the measure of effectiveness. There was no impact of contract cancellation in the income statement at December 31, 2006, 2005 and 2004.

Net investment hedge

We have stopped using investment hedges in foreign subsidiaries. At December 31, 2006, 2005 and 2004, there were no derivatives that qualified as investment hedges.

Equity risks

We may use derivative instruments to manage the equity investments in listed companies that we hold in our portfolio. We may sell call options on shares held in our portfolio and any profit would be measured by the difference between our book value for such securities and the exercise price of the option, plus the premium received.

We may also use derivative instruments on our shares held in treasury. Such transactions are authorized as part of the stock buy back program approved at our shareholders' general meeting held on September 7, 2006.

Since April 2002, we have not had any derivative instruments in place on investments in listed companies or on our shares held in treasury.

Additional information regarding market and credit risks, including the hedging instruments used, is provided in Note 28 to our consolidated financial statements included elsewhere herein.

Research and Development

Expenditures. In 2006, our research and development expenditures were €1,574 million, or 12.8% of 2006 revenues before capitalization of development expenses compared to €1,544 million (11.8% of 2005 revenues).

Accounting policies. In accordance with IAS 38 "Intangible Assets," research and development expenses are recorded as expenses in the year in which they are incurred, except for:

- development costs, which are capitalized as an intangible asset when they strictly comply with the following criteria;
- the project is clearly defined, and the costs are separately identified and reliably measured;
- the technical feasibility of the project is demonstrated;
- the intention exists to finish the project and use or sell the products created during the project;
- a potential market for the products created during the project exists or their usefulness, in case of internal use, is demonstrated; and
- adequate resources are available to complete the project.

These development costs are amortized over the estimated useful lives of the projects concerned. Specifically for software, useful life is determined as follows:

- in case of internal use: over its probable service lifetime; and
- in case of external use: according to prospects for sale, rental or other forms of distribution.

The amortization of capitalized development costs begins as soon as the product in question is released. Capitalized software development costs are those incurred during the programming, codification and testing phases. Costs incurred during the design and planning, product definition and product specification stages are accounted for as expenses.

- customer design engineering costs (recoverable amounts disbursed under the terms of contracts with customers) are included in work in progress on construction contracts.

With regard to business combinations, we allocate a portion of the purchase price to in–process research and development projects that may be significant. As part of the process of analyzing these business combinations, we may make the decision to buy technology that has not yet been commercialized rather than develop the technology internally. Decisions of this nature consider existing opportunities for us to stay at the forefront of rapid technological advances in the telecommunications–data networking industry.

The fair value of in–process research and development acquired in business combinations is based on present value calculations of income, an analysis of the project's accomplishments and an evaluation of the overall contribution of the project, and the project's risks.

The revenue projection used to value in–process research and development is based on estimates of relevant market sizes and growth factors, expected trends in technology, and the nature and expected timing of new product introductions by us and our competitors. Future net cash flows from such projects are based on management's estimates of such projects' cost of sales, operating expenses and income taxes.

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The value assigned to purchased in–process research and development is also adjusted to reflect the stage of completion, the complexity of the work completed to date, the difficulty of completing the remaining development, costs already incurred, and the projected cost to complete the projects.

Such value is determined by discounting the net cash flows to their present value. The selection of the discount rate is based on our weighted average cost of capital, adjusted upward to reflect additional risks inherent in the development life cycle.

Capitalized development costs considered as assets (either generated internally and capitalized or reflected in the purchase price of a business combination) are generally amortized over three to seven years.

In accordance with IAS 36 "Impairment of Assets", whenever events or changes in market conditions indicate a risk of impairment of intangible assets, a detailed review is carried out in order to determine whether the net carrying amount of such assets remains lower than their recoverable amount, which is defined as the greater of fair value (less costs to sell) and value in use. Value in use is measured by discounting the expected future cash flows from continuing use of the asset and its ultimate disposal.

If the recoverable value is lower than the net carrying value, the difference between the two amounts is recorded as an impairment loss. Impairment losses for intangible assets with finite useful lives can be reversed if the recoverable value becomes higher than the net carrying value (but not exceeding the loss initially recorded).

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long–Lived Assets" ("SFAS 144"). SFAS 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long–Lived Assets and for Long–Lived Assets to Be Disposed Of," and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for the disposal of a segment of a business. The provisions of SFAS 144 are required to be applied for fiscal years beginning after December 15, 2001.

During the year ended December 31, 2002, we performed an assessment of the carrying values of acquired technology, booked in our consolidated statements reconciled to U.S. GAAP, pursuant to SFAS 144 in connection with the DSC Communications, Genesys, Kymata, Innovative Fibers and Newbridge acquisitions. The assessment was performed due to sustained negative economic conditions impacting our operations and expected future revenues. As a result, we recorded impairment charges of €553 million related to acquired technology to reflect, in our consolidated statements reconciled to U.S. GAAP, these assets at their current estimated fair values. The impairments represent the amount by which the carrying values of these assets exceeded their fair values.

During the year ended December 31, 2006, no trigger events occurred that would require us to reassess the carrying values of acquired technology.

Application of accounting policies to certain significant acquisitions. In accounting for, and reconciling under U.S. GAAP, our acquisitions of Lucent and the UMTS business of Nortel in 2006, Spatial in 2004, Timetra in 2003 and Genesys and Newbridge in 2000, our selected financial data stops at 2002, we allocated a significant portion of the purchase price of each acquisition to in–process research and development projects.

Set forth below is a description of our methodology for estimating the fair value of the in–process research and development of Genesys, Newbridge, Timetra, Spatial, Lucent and the UMTS business of Nortel at the time of their acquisition. We cannot give assurances that the underlying assumptions used to estimate expected project revenues, development costs or profitability, or the events associated with such projects, as described below, will take place as estimated.

Genesys. At the acquisition date, Genesys was conducting design, development, engineering and testing activities associated with the completion of several projects related to Genesys release 6. The allocation of U.S.$100 million of the purchase price to the in–process research and development projects represented their estimated fair values using the methodology described above.

Newbridge. At the acquisition date, Newbridge was conducting design, development, engineering and testing activities associated with the completion of numerous projects aimed at developing next–generation technologies that were expected to address emerging market demands for the telecommunications equipment market. The allocation of U.S.$750 million of the purchase price to these in–process research and development projects represented their estimated fair value using the methodology described above. More specifically, the development, engineering and testing activities associated with the following technologies were allocated portions of the purchase price: switching and routing (U.S.$505 million) and access (U.S.$245 million).

Timetra. At the acquisition date, Timetra was developing routers to handle data traffic at what is known as the network edge, the part of the data network that links offices, homes and other buildings to the long distance "core" network. In June 2003, Timetra introduced its first product, a family of service routers for next generation carrier networks. The allocation of U.S.$5.5 million of the purchase price to these in–process research and development projects represented their estimated fair values using the methodology described above.

Approximately U.S.$42 million had been spent on research and development projects as the valuation date. Costs to complete the projects were estimated at approximately U.S.$9 million over 24 months following the acquisition. Management estimated that the aforementioned projects were in various stages of development and were approximately 80% complete, in the aggregate, based on development costs.

At the time of the acquisition, we expected estimated total revenues from the acquired in–process technology would peak in 2006 and 2007 and steadily decline thereafter as other new products and technologies were expected to be introduced by us.

The estimated costs of goods sold as well as operating expenses as a percentage of revenues for Timetra were expect to be materially consistent with historical levels, primarily due to the extremely competitive nature of the industry and the need to continue to spend heavily on research and development.